

# 21.06 Hospitals – Private Sector

## Overview

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The two types of private-sector health care organizations (think hospitals) are\*:

- **Investor-owned** health care entities, which provide goods and services for profit, and
- **Not-for-profit** business-oriented health care entities, which have no ownership interests.

*\*Note that governmental health care organizations constitute a third type of health care entity.*

Not-for-profit health care organizations:

- Charge fees to remain self-sufficient rather than to maximize profits.
- May receive contributions from resource providers in transactions that are either nonreciprocal or are not proportionate.

Accounting and financial reporting for both types of health care organizations is consistent, although each has transactions that would not be appropriate for the other. For example:

- A not-for-profit health care organization will not have any transactions or reporting related to shareholders' equity.
- An investor-owned health care organization will generally not receive contributions.

## Financial Statements

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**Four statements and notes** to the F/S are presented for a private sector health care organization, including:

- Balance sheet (Statement of Financial Position)
- Statement of Changes in Net Assets (or Equity)
- Statement of Cash Flows
- Statement of Operations (Activities)

The statements may have other titles that are appropriately descriptive, such as a statement of financial position instead of the balance sheet, or a statement of activities in place of a statement of operations. The statement of cash flows, however, should be entitled as such.

### Balance Sheet

The Balance Sheet (Statement of Financial Position) classifies assets and liabilities as current or noncurrent on a similar basis as for-profit entities. Net assets of a **not-for-profit** health care organization are identified as **with or without donor restrictions**, similar to other not-for-profit entities. Net assets *without* donor restrictions, however, include those that are *contractually limited*, such as assets limited as to use by an outside party other than a donor—eg, restrictions imposed by state law on many health maintenance organizations (HMOs).

## Statement of Changes in Net Assets

As is true for other NPOs, contributions restricted by the donor, such as for long-term purposes (eg, an endowment), would not be reported in the Statement of Operations. They would instead be reported in the Statement of Changes in Net Assets as a revenue increasing net assets with donor restrictions, as appropriate.

## Statement of Cash Flows

The Statement of Cash Flows, like other not-for-profit entities, is prepared similarly to a statement of cash flows for a private business, reporting cash flows from **operating** activities, from **investing** activities, and from **financing** activities.

## Statement of Operations

The Statement of Operations (Activities) is required to include a **performance indicator**, which may be described as *operating income*, *revenues over expenses*, *revenues and gains over expenses and losses*, or *performance earnings*. The performance indicator is a measure of operating income or loss. It helps in comparing the performance across health care organizations with different organizational forms. Regardless of what description is used, the performance indicator is to be clearly labeled.

- Not-for-profit, business-oriented health care entities are required to report the performance indicator on the same statement that presents the total changes in net assets without donor restrictions.
  - A description of the nature and composition of the performance indicator is to be included in the notes to the F/S. The performance indicator **includes** items related to investments in debt and equity securities:
    - Dividends, interest, and similar investment income
    - Realized gains and losses
    - Unrealized gains and losses on trading securities
    - Credit losses
    - Unrealized gains and losses and impairments on equity investments
- Other changes in net assets may be presented in the same statement or separately.
- Additional classifications may be used for components within the performance indicator, such as operating and nonoperating, expendable and nonexpendable, recognized and unrecognized, or recurring and nonrecurring.
- Certain items are **excluded** from the performance indicator and are reported separately as changes in net assets (see illustration below).

**Patient service revenue** includes revenues for medical services such as doctors, surgery, and most hospital stay costs, etc. and is accounted for in accordance with the new ASC 606 revenue recognition rules.

- Patient service revenue **excludes charity care**, which isn't billed but is disclosed in the F/S. Charity care is also *not* considered uncollectible account expense (ie, credit loss expense).
- **Net patient service revenue** is patient service revenue after reductions for\*:
  - **Implicit price concessions** (ie, a reduction in the price based on the amount the entity does not expect to collect) and

- o **Contractual adjustments** for third-party payments.

*\*Note that credit loss expense is claimed separately as an operating expense.*

- Sometimes, the amount collectible cannot be determined at the time the services are provided, such as when a health care facility is required by law to provide emergency services, regardless of the patient's ability to pay. In this case, a contract is likely to have been bypassed, which would require postponing revenue recognition until it can be determined that the patient has the ability and intention to pay or that the service should be classified as charity care.

**Donated supplies** are recognized as a revenue at FMV in the period received and as either an asset or an expense.

Supplies or Expense	100	
Unrestricted contribution – other operating Revenue (no DR)		100

#### Statement of Operations (Activities) – Hospital (PP-NO-ONE)

Patient service revenue

(Provisions for implicit price concessions and contractual adjustments)

Net patient service revenues

+ Other operating revenues, gains/losses

- o Nonmedical – Parking, gift shop, cafeteria, tuition (auxiliary activities)
- o Donated supplies & equipment
- o Restricted grants
- o Net assets released from restriction used for operations

(Operating expenses)

- o Credit losses (ie, bad debts), drugs, doctor salaries, G&A, depreciation, interest

Results from operations

+ Nonoperating revenues (Other Income)

- o Unrestricted donations, gifts, bequests
- o Unrestricted interest & dividend income
- o Unrestricted grants
- o Donated services

Excess of Revenues/Gains over Expenses/Losses (**Performance indicator**)

**Items reported separately from performance indicator:**

- Donor-restricted contributions
- Contributions of long-lived assets without donor restrictions
- Equity transfers
- Discontinued operations
- Transactions with owners acting in the capacity as an owner
- Items reported in, or reclassified from, other comprehensive income
- Unrealized gains/losses on investments other than trading securities

**Increase in Net Assets Without Restrictions**

**Governmental Health Care Organizations**

Governmental health care organizations are generally considered governmental entities that are engaged only in business-type activities, similar to utilities. As such, a governmental health care organization will present F/S prepared in accordance with the same requirements applied to enterprise funds.

**Summary**

Type of Health Care Organization	Authoritative Guidance	Required F/S
Investor-owned (for-profit) health care entities	FASB	<ul style="list-style-type: none"><li>• Balance sheet (Statement of Financial Position)</li></ul>
Not-for-profit business-oriented health care entities	FASB	<ul style="list-style-type: none"><li>• Statement of Changes in Net Assets (or Equity)</li><li>• Statement of Cash Flows</li><li>• Statement of Operations (Activities)</li></ul>
Governmental health care organizations	GASB	<ul style="list-style-type: none"><li>• Statement of Net Position</li><li>• Statement of Revenues, Expenses, &amp; Changes in Fund Net Position</li><li>• Statement of Cash Flows</li></ul>



**Sample Business Oriented Not-for-Profit Hospital**  
**STATEMENTS OF OPERATIONS (ACTIVITIES)**  
*Years Ended December 31, 20X7 and 20X6*  
(in thousands)

	<u>20X7</u>	<u>20X6</u>
<b>Changes in net assets without donor restrictions:</b>		
Revenue, gains, and other support:		
Net patient service revenue	\$85,156	\$78,942
Premium revenue	11,150	10,950
Other revenue	2,601	5,212
<u>Net assets released from restrictions used for operations</u>	<u>300</u>	<u>—</u>
Total revenues, gains and other support	<u>99,207</u>	<u>95,104</u>
<b>Expenses:</b>		
Operating expenses	88,521	80,585
Depreciation and amortization	4,782	4,280
Interest	1,752	1,825
Provision for <i>credit losses</i>	1,000	1,300
Other	2,000	1,300
<u>Total expenses</u>	<u>98,055</u>	<u>89,290</u>
Operating income	1,152	5,814
<b>Other income:</b>		
Investment income	3,900	3,025
<b>Excess of revenues over expenses (Performance Indicator)</b>	5,052	8,839
Change in net unrealized gains and losses on other than trading securities	300	375
Net assets released from restrictions used for purchase of property and equipment	200	
Change in interest in net assets of Sample Hospital Foundation	283	536
<u>Transfers to parent</u>	<u>(688)</u>	<u>(3,051)</u>
Increase in net assets without donor restrictions	<u>\$5,147</u>	<u>\$6,699</u>

*See accompanying notes to financial statements.*

**Sample Business Oriented Not-for-Profit Hospital**  
**STATEMENT OF CHANGES IN NET ASSETS**  
*Years Ended December 31, 20X7 and 20X6*  
(in thousands)

	<u>20X7</u>	<u>20X6</u>
<b>Net assets without donor restrictions:</b>		
Excess of revenues over expenses	\$ 5,052	\$ 8,839
Net unrealized gains on investments, other than trading securities	300	375
Change in interest in net assets of Sample Hospital Foundation	283	536
Transfers to parent	(688)	(3,051)
Net assets released from restrictions used for purchase of property and equipment	<u>200</u>	<u>—</u>
Increase in net assets without donor restrictions	<u>5,147</u>	<u>6,699</u>
<b>Net assets with donor restrictions:</b>		
Contributions for charity care	140	996
Contributions for endowment funds	50	411
Net realized and unrealized gains on investments	10	10
Net assets released from restrictions	<u>(500)</u>	<u>—</u>
Increase (decrease) in net assets with donor restrictions	<u>(300)</u>	<u>1,417</u>
Increase in net assets	4,847	8,116
Net assets, beginning of year	<u>72,202</u>	<u>64,086</u>
Net assets, end of year	<u>\$77,049</u>	<u>\$72,202</u>